



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Number: **201210042**  
Release Date: 3/9/2012

Date: December 13, 2011

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

UIL: 501.32-00; 501.33-00

Dear :

This is our final determination that you do not qualify for exemption from federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Since you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, you should follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

Letter 4038 (CG) (11-2005)  
Catalog Number 47632S

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois Lerner  
Director, Exempt Organizations

Enclosure  
Notice 437  
Redacted Proposed Adverse Determination Letter  
Redacted Final Adverse Determination Letter



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Date: October 19, 2011

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend

UIL

B = state  
C = date  
D = individual  
E = business  
g = dollar amount  
h = number  
j = dollar amount  
k = dollar amount  
l = dollar amount  
n = number

501.32.00  
501.33-00

Dear :

We have considered your application for recognition of exemption from federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

**Issue**

Do you qualify for exemption under section 501(c)(3) of the Code? No, for the reasons given below.

**Facts**

You were incorporated in the State of B on date C. Your Articles state that you were organized exclusively for educational purposes in accord with section 501(c)(3) of the

Letter 4036 (CG) (11-2005)  
Catalog Number 47630W

Internal Revenue Code ("Code"). More specifically, you are organized to instruct and train individuals for the purpose of improving or developing their capabilities as they relate to the United States Constitution and to instruct the public on subjects useful to individuals and beneficial to the community, again, as they relate to the United States Constitution.

In order to meet this purpose, you intend to offer educational materials on the United States Constitution to groups that form as 'clubs'. Clubs will be groups of at least 40 people who will gather monthly to study and discuss sections of the United States Constitution. Each club will meet on their own time and at the location of their choosing, on average one to three hours per session. They will meet until such time as funded for the purpose of learning about the United States Constitution. The clubs have no formal legal structure. Your staff will provide the educational materials to the clubs and conduct other administrative functions. You will seek out volunteers to moderate the study sessions. You will outline the duties for the moderators and provide them with notes on how to operate in their role as a moderator. You will have no governing or supervisory control over the clubs and will not monitor their activities. No reporting to you is required from any club. You will be available for questions or possible coordination amongst clubs nationwide. Your only other planned activity is potentially creating a newsletter available for download from your web site.

The clubs will be formed independently by interested individuals who can gather a minimum of 40 persons to join them in topical discussions. The clubs will notify you of their formation. You have described the formation process, in short, as follows. Individuals that hear of your educational program through your web site and would like to take part in studying the United States Constitution would contact you whereupon you would provide forms and instructions on how to start a club in their city. As it has been mentioned, you request at least 40 to start but that is not "cut in stone". Once a sufficient amount of interested individuals join and secure a location to meet, they would then be asked to try and locate a volunteer moderator, generally a local lawyer willing to read through the materials you will eventually provide, to moderate discussion. Finally, the club is asked to raise donations, payable to you, sufficient enough to enable the club to start. This, on average, is g dollars per participant, per year, however, no money is required from any one individual to participate with the club. This can be accomplished if the club raises enough funds to cover everyone's materials costs. One of the methods you describe for doing this is through sponsorships.

The clubs are responsible for soliciting sponsorships. Sponsors will be provided advertisements, in the form of placing their name and logo, in the assignment portion of the educational materials used in the discussion groups. Sponsorships will reduce the amount each individual member of the club has to pay for your materials. For example, if a club consists of h members, they will need j dollars total ( $h \times g$ ) for the educational materials. In this example, if the club secures k dollars in advertising sponsorships, the

price per member requirement is reduced. Some may donate more, some less. However, you have no control over the clubs finances and do not care how they raise the g dollars amount per member for the educational materials. You consider the g dollars payment to be a contribution or donation to your organization. If enough funds are generated by clubs, and funds remain after club payments, you may start clubs at high schools - if a teacher is available for moderation. Because funds are available to purchase the educational materials there would be no cost to the high school club.

Your governing body consists of six members, including D, who will be compensated for his role as the Executive Director. You stated that due to D's ownership interests through E he does not have a vote on your board. Your Bylaws indicate that the president is an officer and has the power to execute decisions and be in charge of business affairs. D is listed as your CEO and president.

The educational materials clubs are purchasing are provided by E, which is paid as an independent contractor. The purchase prices of those materials is based on the documented costs of binders and similar texts for sale at retail in the legal community, but price shall be at or less then the average cost of those retail materials researched. Funds that are given to you from clubs are submitted as payment to E. E is owned and operated by D. E owns the copyrights to all of the educational materials and will charge you l dollars for each educational package it produces for you. You have stated E was selected to provide these materials as "no one but E is providing edited Supreme Court opinions with commentary for educating the public". Your governing body approved the contract with E in accordance with your conflict of interest policy. D will provide space in his law office to you free of charge. E is located at the same facility.

You reported a majority of your income as coming from gifts, grants and contributions, however, you reported that the income you receive from the clubs is considered to be donated. You also reported a portion of your income as coming from advertising revenue from donors wishing to get credit in the educational materials as sponsors. Expenses cover mostly the cost of producing the hard copies of the educational materials in binders and the salary to D.

Your website shows that your complete program covers over 300 Supreme Court cases on United States Constitution issues in a four year program. It also provides access to a portion of the educational sessions, which can be purchased online. The site will eventually hold n sessions that can be purchased there. However, these sessions are not identical to what is provided to the clubs.

The website also has a page that sells merchandise bearing your name and logo. You reported that any income that is received through the sales of merchandise is attributable and taxable to E. The same is true of the educational sessions that can be purchased there. You also have instructions on your site on getting a club started, forms

for advertising and donations and solicitation materials for those interested in joining a club.

### **Law**

Section 501(c)(3) of the Code provides, in part, for the exemption from federal income tax to organizations organized and operated exclusively for charitable, religious or educational purposes, where no part of the net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations states that in order to qualify under section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more exempt purposes. If an organization fails to meet either the organizational or operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(2) of the Income Tax Regulations provides an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations states that an organization is not operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. It must not be operated for the benefit of designated individuals or the persons who created it.

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

In est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), several for-profit est organizations exerted significant indirect control over est of Hawaii, a non-profit entity, through contractual arrangements. The question for the court was not whether the payments made to the for-profits were excessive, but whether they benefited substantially from the operation of the applicant. The Tax Court concluded that the for-profits were able to use the non-profit as an "instrument" to further their for-profit purposes. Neither the fact that the for-profits lacked structural control over the organization nor the fact that amounts paid to the for-profit organizations under the contracts were reasonable affected the court's conclusion. Consequently, est of Hawaii did not qualify as an organization described in section 501(c)(3).

In Church by Mail, Inc. v. Commissioner, T.C. Memo 1984-349, *aff'd* 765 F. 2d 1387 (9<sup>th</sup>

Cir. 1985), the Court affirmed a Tax Court decision. Church by Mail sent out sermons in numerous mailings. This required a great deal of printing services. A for-profit company, controlled by the same ministers, provided the printing and the mailing. The services were provided under two contracts. The contracts were signed by the two ministers for both the organization and the for-profit company. The organization's business comprised two-thirds of the overall business done by the for-profit company. The court determined that there was ample evidence in the record to support the finding that the organization was operated for the substantial non-exempt purpose of providing a market for the services of the for-profit company.

In P.L.L. Scholarship Fund v. Commissioner, 82 T.C. 196 (1984), an organization operated bingo at a bar (a for-profit enterprise) for purposes of raising money for scholarships. The board of directors included the bar's owners and accountant, and two other persons. The court reasoned that, because the bar owners controlled the organization and appointed its directors, the organization's fundraising activities could be used to the advantage of the bar owners, and thus, provide them with a maximum private benefit. The organization claimed that it was independent because there was a separate accounting and that no payments were going to the bar. The court maintained that the organization's and the bar's activities were so interrelated as to be "functionally inseparable." A separate accounting did not change that fact. Thus, the organization did not operate exclusively for exempt purposes, but rather benefited private interests – the bar owners. Exemption was properly denied.

In International Postgraduate Medical Foundation v. Commissioner, T.C. Memo 1989-36, the court found an organization that ran tours aimed at doctors and their families was operated to benefit the private interests of an individual who controlled the organization and a for-profit travel agency (H&C Tours). The organization used the H&C Tours exclusively for all travel arrangements. There was no evidence that the organization solicited competitive bids from any travel agency for travel arrangements for its tours other than H&C Tours. The organization spent 90 percent of its revenue on travel brochures prepared to solicit customers for tours arranged by the travel agency. The brochures emphasized the sightseeing and recreational component of the tours, but did not describe the medical curriculum for the seminars and symposia that was the basis for exemption. Educational activities occurred on less than one-half of the days on a typical tour. The court found that a substantial purpose of the organization's operations was to increase the income of H&C Tours. The president of H&C Tours controlled the organization and exercised that control for the benefit of H&C Tours. Moreover, the administrative record supported the finding that the organization was formed to obtain customers for H&C Tours.

### **Application of Law**

Based on our analysis you do not satisfy the operational requirements of the Code and

Regulations to be recognized as exempt under section 501(c)(3) of the Code. Your income will inure to insiders and your operations will result in impermissible private benefit. Moreover, you have not shown that you are formed exclusively for an exempt purpose under section 501(c)(3) of the Code.

Section 1.501(c)(3)-1(a)(1) of the Regulations states that to qualify under section 501(c)(3) you must be both organized and operated exclusively for one or more exempt purposes. You do not meet the operational test as you will be directly benefitting an individual who is an insider and you are not conducting exclusive 501(c)(3) activities. You have stated that clubs have no budgets, no revenue or expenses, they don't buy and sell anything, they have no reporting requirements to you and you will not monitor their activities. This calls into question the activity you are actually conducting, which is only the collecting of funds for turnover to a for profit entity, E, of which your executive director, D, is owner. This directly benefits an insider in a more than substantial manner.

You do not meet the standards of section 1.501(c)(3)-1(d)(1)(ii) of the Regulations as you are serving a private rather than public interests. The overriding factor in determining the purpose for which you were formed is whether any private benefit bestowed on individuals is incidental or substantial in comparison to any qualifying 501(c)(3) activities. Here, you were formed by the owner and operator of E, D, you are contracted with E to purchase materials, you are paying D a salary and D serves in a key role on your governing body. All materials used by you are owned by E. Any similar clubs operated prior to you were run by E. D is your incorporator, president, CEO and your only compensated employee – you have stated no one can run your program like D can. Even though the contract and salary were negotiated by other board members your sole purpose is to facilitate in the purchase of materials from the for profit business of an insider – causing a direct conflict of interest. This provides a substantial, non-incidental benefit to D, and because D is an insider, causes inurement. Section 1.501(c)(3)-1(c)(2) of the Regulations provides an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. The public benefit of providing educational materials does not outweigh the private benefit being caused by your operations, and since those result in inurement, you fail the operational test and do not qualify for exemption under 501(c)(3).

You are similar to the organization denied exemption in est of Hawaii, supra, because E exerts significant control over your organization through its contract with you. The question is not if E is being paid excessively but rather if E benefits from your operations. It is clear that a majority of the income that you generate goes directly to pay E. No club can formally exist without submitting payment for the educational materials package through you. Even though you have stated there is no cost to form and participate in a club, without funds, the club can't get the educational materials to conduct their activities. Your operations cannot take place without funding which buys

materials. A club has no choice but to purchase materials from E if they want to operate – so without the direct link to E there are no operations. As noted in est of Hawaii, E uses you to further their business purpose. This causes a private benefit to be served.

You are similar to the organization denied exemption in PLL Scholarship Fund. The information submitted shows you and E are essentially one in the same. Funds are really just flowing through you to E. You are contractually obligated to purchase materials from E whenever you receive funding, charging a fee for providing the educational materials related to your program. You charge fees that are not substantially less than cost. Here, you are charging club members more than what E charges for materials in order to cover administrative costs, including a salary for D. Sponsorships for materials are really advertising revenue for E. Payments on your web site go directly to E. You have indicated you hope that E is “wildly successful” due to the little overhead involved with internet downloads. Your functions and management are interrelated so as to be functionally inseparable. For this reason you are established to benefit the private interests of D, the owner of E, and are not operated exclusively for exempt purposes.

You are similar to the organization denied exemption in Church by Mail, *supra*, because you are operated for the substantial non-exempt purpose of providing a market for the services of E. This is shown by your exclusive use of E’s materials for your programs and the fact that your website sells E’s merchandise. Further, D’s dual control over you and E enables him to benefit and profit from the affiliation of the two entities through increased revenues to E as well as the compensation D is paid. This benefit constitutes inurement, which precludes exemption under section 501(c)(3) of the Code.

You are also similar to International Postgraduate Medical Foundation, *supra*, because you are operated to benefit the private interests of an individual (D) who controls you and E. As noted previously, you use E exclusively to provide your educational materials. There is no evidence that you solicited any competitive bids from other providers of similar services. A significant portion of your revenue is paid to E, which shows that increasing the income of E is a substantial purpose of your operations. You are controlled by D and he exercises his control to benefit his for-profit business, E. By using E exclusively for providing your educational materials, you are creating a market for E’s materials. This is also shown by the fact that you offer E’s educational materials and merchandise on your website for sale, the proceeds of which are paid to E.

All of these factors show the nonexempt purposes that are being carried out through your operations. As noted in Better Business Bureau of Washington D.C., Inc., *supra*, the presence of a single nonexempt purpose, if significant in nature, precludes exemption under section 501(c)(3). Therefore the significant nonexempt purposes that are a part of your operations clearly prohibit you from being found to be exempt under section 501(c)(3).

### **Applicant's Position**

You contend that all your operations are educational in nature. You reported that once the educational materials are delivered to the clubs, you will still have involvement with their operations. You seek out qualified lawyers and convince them to donate their time to moderate the educational sessions. You also consult with these moderators about ongoing Supreme Court decisions and United States Constitution issues in the news. You do this to ensure the educational sessions are current and relevant. You also take care of potential complaints or issues from club members. Thus, you feel that your work and efforts to educate only begin after the materials are delivered.

You provided a price comparison regarding the amount charged for the educational materials provided by E. You noted that the average cost of similar loose-leaf textbooks for sale at retail in the legal community is less than \$10.00 more.

You indicated that the merchandise that is sold online is strictly operated by E. You note that the page containing the sales is a "for-profit page". It was simply put there more for the fun and camaraderie aspect.

You noted that your future focus will be on high school clubs. In the proposed scenario, you would only sell one copy of the materials and allow the moderators to make copies for the students. Local businessmen have shown interest in funding one or more high school clubs but are only willing if they can take a charitable deduction.

You also compared your organization to an existing 501(c)(3) entity that is paying lawyers to represent conservative positions before the M. You are not paying your lawyers (moderators) and do not take a position on any issue but offer both sides for the sake of education.

### **Service Response to Applicant's Position**

The support you provide to your program by finding lawyer/moderators, consulting with them and taking care of potential issues may enhance how your program is provided. However, it is not the educational value of your program that we have issue with; it is the manner in which you operate. Your operations provide a substantial private benefit to D and his for-profit, E. Further, your income inures directly to D, an insider, immediately disqualifying you from exemption.

Although you compared E's pricing to other similar offerings in the legal community, it is clear that E is not providing the materials at substantially less than cost. Further, of the g dollars that you collect for each educational package, all but \$10.00 dollars is paid directly to E through the contract you have made with them. Thus, your fees are set to

pay E and pay a salary to D.

We see no distinctions between the pages of your website. Any person who views your site has no way of knowing which portions are attributable to the for-profit and which are truly yours. The intermingling of the site allows for E to profit off the persons who are visiting the site for educational purposes. Selling these items clearly provides benefit and profit to E.

You have not adequately described your future educational programs and have failed to establish how your programs will not benefit D or E. Further, we cannot compare your operations to the operations of other organizations as all determination requests are reviewed independently.

### **Conclusion**

Based on the facts and information provided, you have not demonstrated that you do not allow your net earnings to inure to private individuals. Further, there is evidence of a significant private benefit being served to the related for-profit. These are nonexempt purposes. Any public purposes for which you may operate are only incidental to the nonexempt purposes served through your operations. Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

*Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading "Regional Office Appeal". The statement of facts (item 4) must be accompanied by the following declaration:*

*"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."*

*The declaration must be signed by an officer or trustee of the organization who has personal knowledge of the facts.*

*Your appeal will be considered incomplete without this statement.*

*If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.*

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at [www.irs.gov](http://www.irs.gov), Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service  
EO Determinations Quality Assurance  
Room 7-008  
P.O. Box 2508  
Cincinnati, OH 45201

Deliver to:

Internal Revenue Service  
EO Determinations Quality Assurance  
550 Main Street, Room 7-008  
Cincinnati, OH 45202

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Lois G. Lerner  
Director, Exempt Organizations

Enclosure, Publication 892